

Financial Statements

Morehouse General Hospital

Years ended May 31, 2002 and 2001 with Report of Independent Auditors

Morehouse General Hospital

Financial Statements

Years ended May 31, 2002 and 2001

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Report of Independent Auditors

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the accompanying balance sheets of Morehouse Parish Hospital Service District (Morehouse General Hospital) (Hospital) as of May 31, 2002 and 2001, and the related statements of operations and changes in fund balance, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Morehouse General Hospital at May 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Hospital will continue as a going concern. Over the past several years the Hospital incurred significant losses and experienced deterioration in working capital. As more fully described in Note 2 to the financial statements, the Hospital received significant reimbursement under a state program which allowed the Hospital to report revenues in excess of expenses in 2002. However, continued reimbursement under this program cannot be assured. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include adjustments, if any, to reflect the possible future effects on the recoverability and the classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

In accordance with *Government Auditing Standards*, we have issued our report dated November 20, 2002 on our consideration of Morehouse General Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Ernst & Young LLP

November 20, 2002

Morehouse General Hospital

Balance Sheets

	May 31	
	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	\$ 385,980	\$ 159,182
Patient accounts receivable, less allowances for uncollectible accounts of \$1,725,000 in 2002 and \$2,011,000 in 2001	4,465,421	6,106,325
Settlements due from third-party payors	454,907	408,254
Inventories	730,291	736,749
Current assets whose use is limited	270,898	257,100
Prepaid expenses and other assets	140,342	224,672
Other receivables	3,565,826	—
Total current assets	10,013,665	7,892,282
Noncurrent assets whose use is limited	1,429,466	1,378,873
Other assets:		
Amounts due from physicians, net	232,775	47,622
Property, plant, and equipment:		
Land and improvements	888,635	888,635
Buildings	14,403,626	14,383,704
Equipment	22,132,246	22,094,803
	37,424,507	37,367,142
Less accumulated depreciation	(27,381,870)	(25,448,612)
	10,042,637	11,918,530
Total assets	<u>\$ 21,718,543</u>	<u>\$ 21,237,307</u>

	May 31	
	2002	2001
Liabilities and fund balance		
Current liabilities:		
Accounts payable	\$ 2,900,070	\$ 2,274,554
Employee compensation and payroll taxes	1,759,419	1,631,673
Other accrued liabilities	834,551	750,663
Current portion of note payable	116,540	416,540
Current portion of capital lease obligations	816,670	903,253
Current portion of long-term debt	270,898	257,100
Total current liabilities	6,698,148	6,233,783
Note payable, less current portion	316,920	433,460
Capital lease obligations, less current portion	692,810	1,397,108
Long-term debt, less current portion	3,421,320	3,692,217
Total liabilities	11,129,198	11,756,568
Fund balance	10,589,345	9,480,739
Total liabilities and fund balance	<u>\$ 21,718,543</u>	<u>\$ 21,237,307</u>

See accompanying notes.

Morehouse General Hospital

Statements of Operations and Changes in Fund Balance

	Year ended May 31	
	2002	2001
Net patient service revenue	\$ 23,560,753	\$ 23,735,844
Uncompensated care revenue (<i>Note 2</i>)	3,324,823	—
Other revenue	1,401,611	1,223,152
Total revenue	28,287,187	24,958,996
Expenses:		
Salaries and benefits	12,063,777	12,139,112
Medical supplies and drugs	3,041,027	3,122,096
Outside services	3,040,688	2,679,339
Insurance	511,881	481,679
Other supplies	877,689	857,029
Other	3,024,946	3,140,890
Provision for uncollectible accounts	2,181,940	2,157,189
Depreciation	1,993,390	2,481,827
Interest	443,243	496,873
Total expenses	27,178,581	27,556,034
Revenue in excess (deficit) of expenses	1,108,606	(2,597,038)
Fund balance at beginning of year	9,480,739	12,077,777
Fund balance at end of year	\$ 10,589,345	\$ 9,480,739

See accompanying notes.

Morehouse General Hospital

Statements of Cash Flows

	Year ended May 31	
	2002	2001
Operating activities and gains and losses		
Revenue in excess (deficit) of expenses	\$ 1,108,606	\$ (2,597,038)
Adjustments to reconcile revenue in excess (deficit) of expenses to net cash provided by operating activities and gains and losses:		
Depreciation	1,993,390	2,481,827
Interest expense	443,243	496,873
Interest income	(62,722)	(165,931)
Provision for uncollectible accounts	2,181,940	2,157,189
Loss on sale of building and equipment	8,889	—
Changes in operating assets and liabilities:		
Patient accounts receivable	(541,036)	(2,243,842)
Inventories, prepaid expenses, and other assets	90,788	(148,880)
Other receivables	(3,565,826)	—
Settlements due from third-party payors	(46,653)	34,579
Accounts payable	625,516	68,612
Employee compensation, payroll taxes, and other accrued liabilities	211,634	723,720
Net cash provided by operating activities and gains and losses	2,447,769	807,109
Capital and related financing activities		
Purchases of property, plant, and equipment	(126,385)	(147,774)
Payments of capital lease obligations	(790,882)	(635,804)
Payments of note payable and long-term debt	(673,639)	(244,002)
Interest expense	(443,243)	(496,873)
Net cash used in capital and related financing activities	(2,034,149)	(1,524,453)
Investing activities		
Interest income	62,722	165,931
(Increase) decrease in assets whose use is limited	(64,392)	512,709
Loan payments (to) from physician, net	(185,152)	28,694
Net cash (used in) provided by investing activities	(186,822)	707,334
Net change in cash and cash equivalents	226,798	(10,010)
Cash and cash equivalents at beginning of year	159,182	169,192
Cash and cash equivalents at end of year	\$ 385,980	\$ 159,182

Supplemental information

During the year ended May 31, 2001, the Hospital entered into capital leases totaling \$75,644.

During 2001, the Hospital converted \$850,000 of trade accounts payable to a note payable.

See accompanying notes.

Morehouse General Hospital

Notes to Financial Statements

May 31, 2002

1. Organization and Description of Business

Morehouse Parish Hospital Service District (Morehouse General Hospital) (Hospital) was organized on December 17, 1982 under powers granted to parish police juries by the State of Louisiana. The geographical boundaries of the Hospital coincide with those of Morehouse Parish. All corporate powers are vested in a board of commissioners appointed by the Morehouse Parish Police Jury. The Hospital is exempt from income taxes as a political subdivision of the State of Louisiana under Section 115 of the Internal Revenue Code. The Hospital is also exempt from federal income tax under Section 501(a) as a hospital organization described in Section 501(c)(3). The federal income tax exemptions also extend to state income taxes.

2. Operating Results and Liquidity

The Hospital experienced improved operating results in fiscal 2002 as a result of an amendment to the Louisiana Rural Preservation Act. Accordingly, the Hospital became eligible to receive increased state reimbursement for Medicaid and other uncompensated care, and recognized \$3,325,000 of revenue in 2002 related to this program. In future years, the Hospital expects to derive a significant portion of revenue from this program; however, guarantee of continued legislative appropriation of these funds cannot be assured.

In addition, the Hospital has implemented several other initiatives to improve operating results, including:

- The Louisiana Department of Health and Hospitals is reviewing its current payment methodology. Adoption of a DRG-based reimbursement model or a modification to the current per diem methodology using fiscal year 2000 cost reports are possible recommendations. Either recommendation could improve the Hospital's Medicaid payments compared to the current per diem methodology, which uses fiscal year 1992 cost reports as a base.
- The Hospital continues to have an appeal in effect regarding the denial of its application for Sole Community Hospital status. If successful, the Hospital should experience increased Medicare reimbursement.

Morehouse General Hospital

Notes to Financial Statements (continued)

2. Operating Results and Liquidity (continued)

- The Hospital is developing a more aggressive approach to grant funding with the goal of obtaining additional funding sources in the areas of rural health outreach and network development as well as various private foundation alternatives. As part of this strategy, the Hospital is currently investigating a community based Federally Qualified Health Clinic, which could provide grant funding to offset the cost of indigent care and improve primary care access to our community.
- The Hospital continues its physician recruiting efforts. In fiscal year 2002, the Hospital added a family practitioner and a general surgeon. Recently, a pediatrician and anesthesiologist have been added to the Hospital medical staff as well. With the addition of new physicians to the Hospital service area, management believes there could be an increased demand for the Hospital's services.
- The Hospital continues its efforts to improve the efficiency of patient care delivery. An activity based costing system is being considered which would capture direct and overhead cost by unit of service. Also, the Hospital continues to monitor its collection process, staffing, contract services and service delivery programs for opportunities to improve efficiencies of patient care delivery.

Management believes that reimbursement under the Rural Preservation Act will have a significant ongoing positive impact on the Hospital operations and in conjunction with the effects of other actions implemented will allow the Hospital to continue to improve its operating performance, as well as strengthen its financial position. Therefore, management anticipates the Hospital's future operating results will allow it to meet its current operational, debt service, and capital needs. However, there are no assurances that such results will be achieved.

3. Accounting Policies

Basis of Accounting

The Hospital uses the accrual basis of accounting for proprietary funds. Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Hospital has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989.

Morehouse General Hospital

Notes to Financial Statements (continued)

3. Accounting Policies (continued)

New Accounting Standards

The GASB issued Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, which is effective in three phases based on a government’s total annual revenues in the first fiscal year ending after June 15, 2001. Statement No. 34 establishes financial reporting standards for state and local governments. It establishes that the basic financial statements and required supplementary information (RSI) for general-purpose governments should consist of Management Discussion and Analysis, Basic Financial Statements, and RSI, including budgetary comparison schedules. The Statement will be effective for the Hospital in fiscal year 2004 unless earlier adoption is required by the Morehouse Parish Government. Adoption of this standard is not expected to have a material effect on the financial position or results of operations of the Hospital.

Net Patient Service Revenue and Related Receivables

The Hospital provides medical services to government program beneficiaries (approximately 68% of net patient service revenues in 2002 and 69% in 2001 were derived from services furnished to Medicare and Medicaid program beneficiaries) and has agreements with other third-party payors that provide for payments at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

Retroactive settlements are provided for in some of the government payment programs outlined above, based upon annual cost reports; such settlements are estimated and recorded as amounts due from such programs in the financial statements. The difference between these estimates and final determination of amounts to be received based on audits by fiscal intermediaries is reported as an adjustment to net patient service revenue when such determinations are made. Estimated settlements through May 31, 2000 for the Medicare program and May 31, 1998 for the Medicaid program have been reviewed by program representatives and adjustments have been recorded to reflect any revisions to the recorded estimates required. These adjustments resulted in an increase in net patient service revenue of \$30,000 in 2002 and \$498,000 in 2001. The effect of any such

Morehouse General Hospital

Notes to Financial Statements (continued)

3. Accounting Policies (continued)

adjustments that may be made to cost reports still subject to review at May 31, 2002 will be reported in the Hospital's financial position or results of operations as such determinations are made.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Charity Care

The Hospital provides care without charge, or at amounts less than established rates, to patients who meet certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify for charity care, they are not reported as revenue.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Inventories

Inventories are valued at the latest invoice price which approximates the lower of cost (first-in, first-out method) or market.

Morehouse General Hospital

Notes to Financial Statements (continued)

3. Accounting Policies (continued)

Property, Plant, and Equipment

The Hospital records all property, plant, and equipment acquisitions at cost, except for assets donated to the Hospital. Donated assets are recorded at appraised value at the date of donation. The Hospital provides for depreciation of its plant and equipment using the straight-line method in amounts sufficient to amortize the cost of its assets over their estimated useful lives.

Assets held under capital lease obligations are included in equipment. These assets have been recorded at the present value of the minimum lease payments which approximates the fair market value of the leased assets (see Note 8). Amortization of leased assets is provided for using the straight-line method over the term of the related lease and is included in depreciation expense.

Investments

Investments are stated at market value. Investment income is reported as other income. Unrealized gains (losses) reflected in other income were insignificant in 2002 and \$63,000 in 2001.

Cash Equivalents

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

4. Cash and Investments

Statutes authorize the Hospital to invest in United States government obligations, certificates of deposit of national banks located in Louisiana or banks organized under the laws of Louisiana, any federally insured investment, guaranteed investment contracts issued by a financial institution having one of the two highest rating categories of Standard & Poor's Corporation or Moody's Investors Services, or in mutual or trust institutions which are registered with the Securities and Exchange Commission under the Securities Act of 1933 and the Investment Act of 1940, and which have underlying investments consisting solely of securities of the United States government or its agencies.

Morehouse General Hospital

Notes to Financial Statements (continued)

4. Cash and Investments (continued)

The Hospital's bank deposits consist of demand deposit accounts and certificates of deposit. These bank deposits are included in cash and cash equivalents and assets whose use is limited. At May 31, 2002 and 2001, the Hospital's deposits were fully insured or collateralized with securities held by the agent of the pledging banks in the Hospital's name.

In addition to the bank deposits held, the Hospital had invested \$942,587 and \$907,703 at May 31, 2002 and 2001, respectively, in a mutual fund whose underlying investments consist solely of securities of the United States government or its agencies (see Note 5). These funds are recorded in assets whose use is limited on the balance sheets.

5. Assets Whose Use Is Limited

The terms of the Hospital's 1997 Revenue Bonds require funds to be maintained on deposit in certain accounts with the trustee (see Note 9). The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the Bond Resolution.

In addition, the Hospital's board of commissioners has designated certain assets to be used for future plant and equipment additions. The composition of assets whose use is limited as of May 31, 2002 and 2001 was as follows:

	May 31	
	2002	2001
Board-designated assets:		
Certificates of deposit	\$ 122,550	\$ 113,690
Mutual fund investments	942,587	907,703
	<u>1,065,137</u>	<u>1,021,393</u>
Trusted funds (principally United States government obligations):		
Construction Fund	—	10,436
Debt Service Fund	2,211	1,992
Debt Service Reserve Fund	523,119	516,364
Capital Additions and Contingencies Fund	109,897	85,788
	<u>635,227</u>	<u>614,580</u>
Total assets whose use is limited	<u>1,700,364</u>	<u>1,635,973</u>
Less current portion	(270,898)	(257,100)
Noncurrent assets whose use is limited	<u>\$ 1,429,466</u>	<u>\$ 1,378,873</u>

Morehouse General Hospital

Notes to Financial Statements (continued)

6. Other Receivables

Other receivables primarily consist of \$3,325,000 due from the State of Louisiana related to the Hospital's reimbursement of Medicaid uncompensated care through the Louisiana Rural Preservation Act.

7. Employee Retirement Plan

The Hospital sponsors a noncontributory, defined contribution retirement plan, which covers substantially all full-time employees after they have met certain eligibility requirements. Under the provisions of the plan document, the Hospital is required to contribute 10% of the eligible employee's salary. The plan provides for the contributions (and interest allocated to the employee's account) to become partially vested after three years of continuous employment and fully vested after seven years of continuous employment. The unvested portion of an account of an employee who terminates employment before becoming fully vested is used to reduce the Hospital's current year contribution requirement. For the years ended May 31, 2002 and 2001, the contribution requirements were \$880,476 and \$874,166, respectively.

The Hospital has an additional retirement plan which covers all employees not covered under the above plan. Under the provisions of the plan, the Hospital was required to contribute 7.50% of the participating employee's salary for 2002 and 2001. The employee becomes partially vested after three years of continuous employment and fully vested after seven years of continuous employment. For the years ended May 31, 2002 and 2001, the contribution requirements were \$47,829 and \$60,614, respectively.

Contributions made during the periods for both plans discussed above were \$1,045,568 and \$419,970 in 2002 and 2001, respectively. The Hospital's unfunded contribution requirement related to both plans of \$205,016 and \$314,310 at May 31, 2002 and 2001, respectively, is included in other accrued liabilities on the balance sheet. Total payroll for all employees was \$9,569,755 and \$9,853,977 for the years ended May 31, 2002 and 2001, respectively. Substantially all employees of the Hospital are covered by one of the two plans discussed above.

The Hospital established the Morehouse General Hospital Tax Deferred Savings Plan. This plan, which qualifies as a tax-sheltered annuity plan under Section 403(b) of the Internal Revenue Code, covers all employees who elect to participate. The plan allows

Morehouse General Hospital

Notes to Financial Statements (continued)

7. Employee Retirement Plan (continued)

participants to defer a portion of their annual compensation. The amount of annual contributions to the plan by participants is subject to certain limitations as defined in the plan agreement. The participants vest 100% immediately in their contributions and investment earnings of the plan. The plan agreement allows discretionary employer contributions to be made to the plan. No employer contributions were made during the years ended May 31, 2002 and 2001.

Retirement expense, net of forfeitures, related to the above plans included in fiscal and administrative services on the statements of revenue, expenses, and fund balance was \$867,789 and \$899,804 for the years ended May 31, 2002 and 2001, respectively.

8. Leases

The Hospital has entered into capital leases for various types of equipment. Under the terms of the leasing arrangements, the Hospital is obligated to pay a monthly rental payment over the primary terms of the leases, which range from five to seven years.

Future minimum lease payments, by year and in the aggregate, under capital leases consisted of the following at May 31, 2002:

Fiscal year ending May 31:

2003	\$1,010,136
2004	729,846
2005	104,255
2006	5,013
Total minimum lease payments	<u>1,839,250</u>
Amount representing interest (ranging from 2.08% to 13.54%)	<u>329,770</u>
Present value of net minimum lease payments (including \$816,670 classified as current)	<u><u>\$ 1,509,480</u></u>

The cost of leased assets included in equipment totaled \$3,503,492 and \$4,216,448 and accumulated amortization was \$1,914,621 and \$2,248,163 at May 31, 2002 and 2001, respectively. The equipment collateralizes the capital lease obligations.

Morehouse General Hospital

Notes to Financial Statements (continued)

9. Long-Term Debt

The Hospital's long-term debt as of May 31, 2002 and 2001 consisted of bonds payable as follows:

	<u>2002</u>	<u>2001</u>
Hospital Revenue Bonds, Series 1997	\$ 3,692,218	\$ 3,949,317
Less amounts due within one year	(270,898)	(257,100)
	<u>\$ 3,421,320</u>	<u>\$ 3,692,217</u>

On November 3, 1997, the Hospital issued \$4,750,000 of Hospital Revenue Bonds (Series 1997) which are term bonds with an annual interest rate of 5.24%. Payment of the scheduled principal and interest on the 1997 Revenue Bonds is due in monthly installments of \$38,159. The 1997 Revenue Bonds are obligations of the Hospital secured by a pledge of the Hospital's revenue.

Under the terms of the Bond Indenture, the Hospital is required to maintain, among other provisions, a specified minimum debt service coverage ratio. In 2002, the Hospital is in compliance with the covenants under the Bond Indenture. In 2001, the debt service coverage ratio was not met and the Hospital obtained a satisfactory waiver of this noncompliance.

10. Note Payable

In 2001, the Hospital settled a dispute with a former pharmacy benefit manager converting trade accounts payable into a note payable of \$850,000 with an interest rate of 10%. The agreement calls for monthly payments of principal and interest of \$18,050 through August 2004.

11. Commitments and Contingencies

During the ordinary course of operations, the Hospital has been named a defendant in lawsuits alleging medical malpractice. Through October 31, 2002, the Hospital was insured for malpractice insurance coverage on a claims-made basis for individual claims up to \$100,000 including a \$50,000 deductible per claim. At November 1, 2002, the Hospital became self-insured for individual claims up to \$100,000. For individual malpractice claims in excess of \$100,000. The Hospital participates in the State of

Morehouse General Hospital

Notes to Financial Statements (continued)

11. Commitments and Contingencies (continued)

Louisiana Patient Compensation Fund. This fund provides malpractice insurance coverage on a claims-made basis for claims up to the statutory maximum exposure of \$500,000, which currently exists under Louisiana law, plus interest and future medical costs. The Hospital has purchased additional malpractice insurance providing coverage up to \$900,000 in the aggregate.

The Hospital has purchased commercial insurance which provides first-dollar coverage for workers' compensation claims. The Hospital is self-insured for employee health insurance up to \$75,000 per claim. A liability is recorded when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. Liabilities for claims incurred are reevaluated periodically to take into consideration recently settled claims, frequency of claims and other economic and social factors. The Hospital purchased commercial insurance which provides coverage for employee health claims in excess of the self-insured limits.

Changes in the Hospital's aggregate claims liability for medical malpractice, workers' compensation, and employee health insurance in fiscal years 2002 and 2001 were as follows:

Year Ended September 30	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
2002	\$ 566,000	\$ 1,386,000	\$ 1,314,000	\$ 638,000
2001	\$ 461,000	\$ 1,535,000	\$ 1,430,000	\$ 566,000

Morehouse General Hospital

Notes to Financial Statements (continued)

12. Net Patient Service Revenue

Net patient service revenue is comprised of the following:

	<u>2002</u>	<u>2001</u>
Total gross patient service charges (excluding charity care of \$125,644 in 2002 and \$69,194 in 2001)	\$ 46,693,143	\$ 46,783,123
Contractual and other allowances:		
Medicaid	5,189,322	4,886,530
Medicare	12,742,660	12,863,342
Managed care organizations	3,547,145	3,836,297
Other	1,653,263	1,461,110
Total contractual and other allowances	<u>23,132,390</u>	<u>23,047,279</u>
Net patient service revenue	<u><u>\$ 23,560,753</u></u>	<u><u>\$ 23,735,844</u></u>

13. Subsequent Event

On September 11, 2002, the Hospital borrowed \$1,000,000 from a local financial institution in conjunction with a certificate of indebtedness issued by the Morehouse Parish Hospital Service District No. 1. The Hospital repaid the \$1,000,000 plus interest in October 2002 after receipt of the uncompensated care reimbursement from the State of Louisiana.

Report of Independent Auditors on Compliance
and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed
in Accordance With *Government Auditing Standards*

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the financial statements of Morehouse Parish Hospital Service District (Morehouse General Hospital) (the Hospital) as of and for the year ended May 31, 2002, and have issued our report thereon dated November 20, 2002. Our report has been modified to describe our substantial doubt about the Hospital's ability to continue as a going concern. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance, except as noted below, that are required to be reported herein under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Morehouse General Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited

may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Morehouse Parish Hospital Service District in a separate letter dated November 20, 2002.

This report is intended for the information and use of the board of commissioners, management, and the Office of Legislative Auditor, State of Louisiana and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

November 20, 2002

Report of Independent Auditors on Compliance With Bond Resolution

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the financial statements of Morehouse Parish Hospital Service District (the Hospital) as of and for the year ended May 31, 2002, and have issued our report thereon dated November 20, 2002. The report has been modified to describe our substantial doubt about the Hospital's ability to continue as a going concern. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

In connection with our audit, nothing came to our attention that caused us to believe that the Hospital failed to comply with the terms, covenants, provisions, or conditions of Sections 2.7, 4.1, 4.2, 5.1, 5.2 through 5.6, 6.1, 6.9, and 10.1 of the Bond Resolution relating to \$4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by the Morehouse Parish Hospital Service District on November 3, 1997, except as noted below, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of the board of commissioners, management, the bond trustee, and the Office of Legislative Auditor, State of Louisiana and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

November 20, 2002

Independent Accountants' Review Report on Schedule of Debt Service Coverage Ratio

The Board of Commissioners
Morehouse Parish Hospital Service District

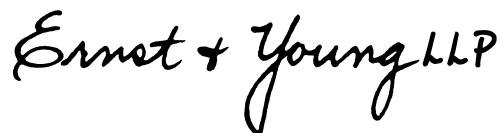
We have reviewed the accompanying Schedule of Debt Service Coverage Ratio for the year ended May 31, 2002 of Morehouse Parish Hospital Service District. Our review was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

A review is substantially less in scope than an audit, the objective of which is the expression of an opinion on the accompanying Schedule of Debt Service Coverage Ratio. Accordingly, we do not express such an opinion.

The Schedule of Debt Service Coverage Ratio is prescribed by Section 5.1 of the Bond Resolution relating to \$4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by Morehouse Parish Hospital Service District on November 3, 1997.

Based on our review, nothing came to our attention that caused us to believe that the accompanying Schedule of Debt Service Coverage Ratio is not presented in conformity with the basis set forth in the accompanying note.

This report is intended solely for the information and use of the board of commissioners, management, and the bond trustee and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink that reads "Ernst & Young LLP".

November 20, 2002

Morehouse Parish Hospital Service District

Schedule of Debt Service Coverage Ratio

Year ended May 31, 2002

(Unaudited)

Revenue in excess of expenses	\$ 1,108,606
Depreciation	1,993,390
Interest	<u>424,563</u>
Income available for debt service	<u>\$ 3,526,559</u>
 Maximum annual debt service requirements	 <u>\$ 457,911</u>
 Debt service coverage ratio	 <u>7.70</u>
Requirement	<u>1.25</u>

See independent accountants' review report and accompanying note.

Morehouse Parish Hospital Service District

Note to Schedule of Debt Service Coverage Ratio

May 31, 2002

(Unaudited)

1. Basis of Presentation

The computation in the Schedule of Debt Service Coverage Ratio is prescribed by Section 5.1 of the Bond Resolution relating to \$4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by Morehouse Parish Hospital Service District on November 3, 1997.

Morehouse Parish Hospital Service District

Schedule of Amounts Paid to Board of Commissioners

Year ended May 31, 2002

The following is a schedule of amounts paid to the board of commissioners for Morehouse Parish Hospital Service District for the year ended May 31, 2002:

Gary Stevenson	\$ 200
Mattie Washington	200
Alfred Twymon	280
John Shackelford	<u>280</u>
Total	<u><u>\$ 960</u></u>

The Board of Commissioners
Morehouse Hospital Service District

In planning and performing our audit of the financial statements of Morehouse Hospital Service District (Morehouse General Hospital) (the Hospital) for the year ended May 31, 2002, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

During our audit, the following matters came to our attention that we believe merit your consideration.

Significant Estimation Process

Monitoring Third-Party Settlement Estimates

Due to a lack of information from the fiscal intermediary, primarily concerning the Medicare outpatient program, the due dates of the Hospital's 2002 and 2001 cost reports have been delayed. Accordingly, the settlement amounts included in the audited financial statements are based on an estimate prepared by management instead of the filed cost report. Additionally, the reimbursement structure for many government programs is in transition, thus creating additional uncertainty.

We recommend management continue to monitor and refine the third-party accounting process to ensure the accuracy of its third-party settlement assets and liabilities.

Management's Response

Management has and will continue to monitor the third-party accounting process. Management has no control over the availability of information from its fiscal intermediary and does not perceive a significant problem.

Other Matters

Interim Financial Reporting

Management has not consistently made adjustments at month end to appropriately state the third-party settlement accounts and home health accounts receivable based on the outcome of their process to estimate these balances. While management ensures the balances are appropriately stated at year end, the interim monthly financial statements do not reflect accurate information.

We recommend that management adjust these accounts on a monthly basis to reflect the appropriate balance based on management's estimation process.

Management's Response

Please see above comment regarding third-party settlement. Again, we don't perceive this to be a significant problem. Management did not make certain adjustments on an interim basis as we approached year end to the home health accounts receivable mainly due to the knowledge that an even larger positive adjustment would be made for the uncompensated care reimbursement recently received. Management will make the adjustments monthly as suggested and will consider a method to estimate the uncompensated care reimbursement as well.

Professional Liability Reserve

As of November 1, 2002, the Hospital assumed responsibility for the first \$100,000 for each medical malpractice claim made after November 1, 2002. Accordingly, management will be responsible for estimating the Hospital's portion of the total liability for malpractice claims in subsequent financial statements.

We recommend that management develop a process for the estimation of this liability in order to fairly state the interim financial statements as well as the year-end audited financial statements.

Management's Response

Management has developed that estimate in conjunction with the audit process and will continue to monitor on an interim basis.

Regulatory Environment Issues

Health Insurance Portability and Accountability Act (HIPAA)

The Health Insurance Portability and Accountability Act (HIPAA) is arguably the single most far-reaching piece of health care legislation in the history of the United States health system. For the first time, the federal government has established standards for the use and access to protected health information. The law, passed in 1996, encompasses accountability and funding provisions for fraud and abuse, portability of health insurance for employees, and administrative simplification measures for all “covered entities” (providers, payers, and clearinghouses). Included in the administrative simplification provisions are various rules and regulations for standard transactions, code sets, and identifiers. It also includes specific regulations for maintaining the confidentiality (privacy) and security of health information. The final rule for transaction and code sets was published in August 2000 with a compliance date of October 2002 without the submission of a compliance plan, or October 2003 with the submission of a compliance plan by all covered entities. The final rule for privacy was passed in December 2000 and covered entities are to be compliant by April 2003. The final rules for security and identifiers are expected to be published sometime in 2003 with compliance probably sometime in 2004.

Therefore we recommend that the Hospital review both the final as well as the proposed rules in an effort to determine the necessary resources that will be required for compliance. We further recommend that the Hospital develop an implementation plan to help ensure that operational compliance can be achieved within the required timeline. Although the rules specify fines and penalties for noncompliance, the real penalty is that organizations that do not comply with these rules may no longer be able to transact their business.

Management’s Response

Management has an active HIPAA compliance committee and remains committed to comply with both privacy for April 2003, and transaction and code sets in October 2003.

Implementation of Governmental Accounting Standards Board Statement 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments (GASB 34)

GASB is required to be implemented in phases starting with state and local governments with fiscal years beginning after June 15, 2001. The year in which the Hospital is required to implement the standard is dependent on several factors, one of which is the possible requirement of the Morehouse Parish Government to have the Hospital adopt the standard because of required inclusion of the Hospital financial statements in the parish government’s financial statements. Absent the need to adopt the standard under the direction of the parish government, the Hospital would be required to adopt GASB 34 in fiscal year 2004.

We suggest that management contact the Morehouse Parish Government to ensure that management is aware of all the factors affecting the timing of the adoption of GASB 34 by the Hospital.

Management's Response

Management will continue to communicate with the Morehouse Parish Government in case we are required by them to adopt the standard prior to fiscal year 2004.

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This report is intended solely for the information and use of the board of commissioners and management and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Ernst & Young LLP

November 20, 2002